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OCC Updates Guidance on Cryptoasset-related Activities of Banks

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On November 23, 2021, the Office of the Comptroller of the Currency ("OCC") published a letter by its Chief Counsel (Interpretive Letter 1179) clarifying earlier interpretive letters issued under former Acting Comptroller Brian Brooks regarding (1) the permissibility of certain cryptoasset, distributed ledger and stablecoin activities for national banks and federal savings associations (collectively referred to as "banks"); and (2) the OCC's standards for chartering national trust banks.[1] In short, the new letter does not explicitly overturn the prior letters but, instead, requires a bank to receive the OCC's prior approval, which might not be easy to obtain, before conducting a new activity under one or more of the prior letters.

Below we provide our key takeaways on what the clarifications mean for the ongoing policy processes regarding innovation issues, followed by a brief summary of the new letter.

KEY TAKEAWAYS

- The new interpretation confirms that many cryptoasset-related activities may be legally permissible for banks but requires a bank to receive supervisory non-objection regarding risk management systems and controls prior to engaging in any such activity.[2]
- This new process, which generally appears to be outside of the processes envisioned in the earlier letters, will provide the OCC significant additional discretion in determining whether and under what conditions to permit any particular bank to engage in cryptoasset-related activities.
- How the OCC exercises that discretion may not be transparent to the public, given the confidentiality generally afforded to supervisory communications. As a result, it may be hard for market participants to discern exactly what the OCC's standards are and the extent to which those standards are applied consistently to all firms (but see the final bullet below regarding the potential for additional forthcoming guidance).
- Acting Comptroller Michael J. Hsu summed up the new approach by stating that it "should not be interpreted as a green light or a solid red light, but rather as reflective of a disciplined, deliberative, and diligent approach to a novel and risky area. We will proceed carefully and cautiously and will hold banks to the same."[3]
- Because the focus of approval likely will be on risk management and compliance, the new supervisory review process may be easier to satisfy for firms with larger and more mature risk and compliance functions.
- The new supervisory review process of risk management systems and controls also could be relevant to the ongoing debate regarding the regulation of stablecoins.

  - In particular, the President's Working Group, OCC and Federal Deposit Insurance Corporation have recommended that Congress pass legislation to require stablecoin issuers to be insured depository institutions and to provide federal agencies with regulatory authority over custodial wallet providers and key participants in stablecoin arrangements (our prior analysis of the recommendations is available here).
  - If any such legislation were to be enacted, presumably the OCC's risk management reviews and standards would dictate whether and under what circumstances the OCC would grant a bank charter for such a standalone stablecoin issuer.
  - Further, the regulators' alternative recommendation is that the Financial Stability Oversight Council pursue its authority to designate certain activities conducted within stablecoin arrangements as systemically important payment, clearing and settlement activities.
  - Any such designated activities then would be subject to risk management standards adopted by federal regulators. Such new risk management standards very well may be informed by the types of expectations the OCC has of banks that engage in permitted cryptoasset-related activities.
- Regarding its standards for chartering national trust banks, as we previously indicated, we believe the bottom line from the new OCC letter is that there is a path available to charter a national trust bank engaged in cryptoasset-related activities, but that path is narrower than the path envisioned by former Acting Comptroller Brian Brooks and may not be attractive to the same set of firms that previously considered pursuing national trust bank charters. Further, it would seem that a threshold issue for any firm seeking such a charter would be whether it can meet the OCC's risk management standards for cryptoasset-related activities.
- The new letter was published the same day the federal banking agencies issued a brief statement outlining cryptoasset-related issues that the agencies will continue to address throughout 2022, including the safety and soundness expectations with respect to such activities. Thus, there may be more details forthcoming about how the OCC and other agencies will evaluate risk management and safety and soundness issue.

NEW CLARIFICATIONS ON CRYPTOASSET-RELATED ACTIVITIES

In addition to the standards for chartering national trust banks, the Chief Counsel's letter clarifies the following prior OCC letters:

- Interpretive Letter 1170, discussing permissible cryptoasset custody services.[4]
- Interpretive Letter 1172, discussing whether banks may hold dollar deposits serving as reserves backing stablecoins in certain circumstances.[5]
- Interpretive Letter 1174, discussing whether (1) banks may act as nodes on an independent node verification network (*i.e.*, distributed ledger) to verify customer payments and (2) banks may engage in certain stablecoin activities to facilitate payment transactions on a distributed ledger.[6]

Under the new clarification, these previously issued letters remain valid, but a bank first must seek and receive its OCC supervisory office's written non-objection before engaging in an activity addressed in the interpretive letters.

To obtain supervisory non-objection, the bank will need to demonstrate that it has adequate systems in place to identify, measure, monitor, and control on an ongoing basis the risks associated with the proposed cryptoasset activities, including operational risk (*e.g.*, the risks related to new, evolving technologies, the risk of hacking, fraud, and theft and third party risk management), liquidity risk, strategic risk and compliance risk.

With respect to compliance, the bank must demonstrate in writing that it understands the requirements under the federal securities laws, the Bank Secrecy Act, anti-money laundering, the Commodity Exchange Act and consumer protection laws, as applicable to its proposed activities. In particular, the letter highlights that a bank should understand

that stablecoins may be securities subject to securities laws and regulations, depending on the particular structure.[7] After a bank has received supervisory non-objection, the OCC will review the new cryptoasset activities as part of its ordinary supervisory processes.

NEW CLARIFICATION ON NATIONAL TRUST BANK CHARTERS

The new letter also addresses Interpretive Letter 1176, which clarified the OCC's views on its authority to charter, or approve the conversion to, a national bank that limits its operations to those of a trust company and activities related thereto. Under former Acting Comptroller Brooks, this chartering authority was pursued by several cryptoasset firms. The new letter appears to indicate that, going forward, the OCC will be more discerning about granting national trust bank charters to cryptoasset-focused firms than under Brooks's leadership.

The OCC's authority to charter national trust banks comes from 12 U.S.C. § 27(a), which provides that a national bank that limits its activities to those of a trust company and activities related thereto is not illegally constituted. According to Interpretive Letter 1176, there is no textual or other statutory guidance on what constitutes a "trust company" and the phrase contained in 12 U.S.C. § 27(a) has been interpreted to include the activities of trust departments of banks and the activities of state trust companies and trust banks. Interpretive Letter 1176 discusses three primary statutory sources from which the OCC may interpret a trust activity to be permitted for national banks (and, thus, activities that also could be conducted by a national trust bank). These authorities are described in the bullets below.

Notably, the new letter states that Interpretive Letter 1176 "is limited to how the OCC may view 12 U.S.C. § 27(a) in the context of a charter application". This statement appears to limit the scope of Interpretive Letter 1176, which as described below appears to address the scope of fiduciary and non-fiduciary trust authorities potentially available for national banks generally, including outside the context of a charter application. This limit of the scope of Interpretive Letter 1176, consistent with the new letter's supervisory non-objection process, may have been intended to ensure that banks do not engage in new activities under Interpretive Letter 1176 without the OCC's review and approval. Thus, it is not entirely clear whether the OCC will apply the broader statements about available fiduciary and non-fiduciary trust authorities made in Interpretive Letter 1176 only in the context of a charter application or will apply those interpretations more generally.

- First, 12 U.S.C. § 92a and 12 CFR Part 9 govern the ability of national banks to engage in activities in a "fiduciary capacity". They enumerate activities or roles that fall under the definition of fiduciary capacity (*e.g.*, acting as trustee, transfer agent or investment adviser if the bank receives a fee for its investment advice) and provide that the OCC may authorize activities in which a bank acts in any "other similar capacity" under 12 U.S.C. § 92a.
    - Interpretive Letter 1176 clarifies the factors that the OCC will consider when determining whether an activity falls under this "other similar capacity" prong, which include (1) whether the activity involves the exercise of discretion on behalf of a client or third party in a manner that would have an economic impact on the client or third party; and (2) whether, in carrying out the discretionary activities, the bank is subject to the duties or standards of behavior that are customarily associated with being a fiduciary.[8]
    - The new interpretive letter does not appear to modify these standards.
- Second, Interpretive Letter 1176 also explains that 12 U.S.C. § 92a provides a bank with the power to engage in "any other fiduciary capacity in which State banks, trust companies, or other corporations which come into competition with national banks are permitted to act under the laws of the State in which the national bank is located".[9] This is known as the "bootstrap" provision of 12 U.S.C. § 92a and authorizes national banks to engage in all fiduciary activities of state trust banks located in the same state as the national bank.
    - Interpretive Letter 1176 states that a bank may rely on the bootstrap provision to conduct fiduciary activities authorized under state law if the OCC determines that the bank is engaging in the relevant activity, role or function consistent with the parameters provided for in the relevant state law for a state bank.

- The new letter suggests that the OCC may limit its use of such authority as it emphasized that "an applicant's activities will not automatically be deemed to be trust activities—or to be fiduciary activities—solely by virtue of state law" and that the agency will retain its discretion to determine what activities are considered trust or fiduciary activities for purposes of federal law.[10]

- Third, under 12 U.S.C. § 24 (Seventh), the OCC may authorize banks to engage in specific activities that are part of the "business of banking" and incidental to the business of banking.
  - Interpretive Letter 1176 provides that the OCC may use such authority to authorize a bank to engage in an activity permitted for a state trust bank if the OCC is satisfied that the following factors required to be considered for such an authorization are sufficiently met:
    - Whether the activity is the functional equivalent to, or a logical outgrowth of, a recognized banking activity.
    - Whether the activity strengthens the bank by benefiting its customers or its business.
    - Whether the activity involves risks similar in nature to those already assumed by banks.
    - Whether the activity is authorized for state-chartered banks.
  - The OCC noted that when considering these business of banking factors, the OCC has the discretion to vary the weight given to each factor.[11]
  - Accordingly, as with the bootstrap provision, the new letter suggests that the OCC may limit the weight placed on the fourth factor when considering 24(Seventh) authority based on the letter's emphasis on how the agency retains discretion with respect to what activities are trust activities under federal law.

In addition, Interpretive Letter 1176 states that "[a] national trust bank may be permitted to engage in any and all activities permitted under state law for a state trust company located in the same state under the plain terms of 12 U.S.C. § 27(a)".[12] The new letter does not appear to modify this statement. Further, the new letter does not appear to withdraw the OCC's conclusion in Interpretive Letter 1176 that there is no *de minimis* rule regarding national banks' use of trust powers (*i.e.*, there is no requirement that such a bank perform primarily in a fiduciary capacity).

In the context of charter conversions, Interpretive Letter 1176 noted that in addition to the statutory authorities reviewed above, 12 U.S.C. § 35 permits the OCC to permit an institution converting from a state to a federal charter to retain assets that do not conform to the requirements applicable to national banks. The new letter does not discuss this authority.

[1] Current Acting Comptroller Michael J. Hsu previously had announced that he would review the OCC's past actions regarding cryptoasset activities and cryptoasset firm charters shortly after taking office.

[2] The new letter characterizes this framework as reflecting the principle that an activity cannot be part of the "business of banking" (*i.e.*, legally permissible) if the bank in question lacks the capacity to conduct the activity in a safe and sound manner. *See* Interpretive Letter 1179 at 3, n.9 ("[A] proposed activity cannot be part of the 'business of banking' if the bank in question lacks the capacity to conduct the activity on a safe and sound basis.").

[3] Acting Comptroller Michael J. Hsu, "Modernizing the Financial Regulatory Perimeter" (Nov. 16, 2021), *available* here.

[4] Interpretive Letter 1170 (July 22, 2020).

[5] Interpretive Letter 1172 (Sept. 21, 2020).

[6] Interpretive Letter 1174 (Jan. 4, 2021).

[7] *See* Interpretive Letter 1179 at n.11. This point was also previously discussed in Interpretive Letters 1170 and 1172.

[8] *See* Interpretive Letter 1176 at 4-5.

[9] *See* Interpretive Letter 1176 at 3.

[10] *See* Interpretive Letter 1179 at n.5.

[11] *See* Interpretive Letter 1176 at n.11. Interpretive Letter 1176 adds that "[g]iven this fourth factor, 'Whether the activity is authorized for state-chartered banks,' an activity permitted for state trust banks may be part of the business of banking under the authority of 12 U.S.C. § 24(Seventh) for national banks if the activity is authorized for state-chartered banks, and the OCC is satisfied that the remaining three factors are also sufficiently met". *Id.* at 6.

[12] *See* Interpretive Letter 1176 at 6.